

AFP® Annual Conference

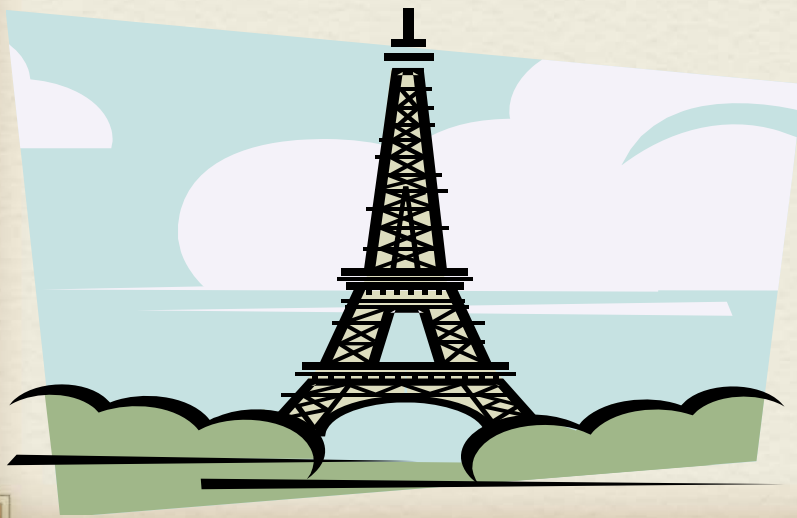
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ORIGINAL
ESSENTIAL
UNBIASED
INFORMATION



IAT– A 360 Degree View: The Good, The Bad, The Ugly, The Beautiful



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Jim Dana, AAP, Banking Project Manager, ADP, Inc.

Agenda

- **The Good-Jim Dana**
- The Bad & Ugly-Steve Bernstein
- The Beautiful - Rossana Salaris

What is IAT ?

- IAT stands for **International ACH Transaction**
 - An IAT transaction has a new ACH format
 - The IAT format has many more records than most domestic ACH formats-in order to further identify the originator and the receiver. For example:
 - Domestic ACH direct deposit format – Only one Detail Record per deposit
 - IAT ACH direct deposit format – Additional 7-12 Addenda Records per detail record
 - Originator & Receiver addresses are required for all IAT transactions
-

NACHA's IAT Definition

“An ACH entry that is part of a *payment transaction involving* a financial agency's office that is not located in the territorial jurisdiction of the U.S.”

- “A financial agency is ‘*involved*’ if one or more of the following applies to that financial agency / financial institution:
 - It holds an account that is credited or debited as part of a payment transaction
 - It receives funds directly from a Person or makes payment directly to a Person as part of a payment transaction
 - It serves as an intermediary in the settlement of any part of a payment transaction”

Payment Transaction

- **“Payment Transaction”** is not defined by NACHA, so OFAC requested that the following be included in the ACH Operating Guidelines

“It is an instruction of a sender to a bank to pay, or to obtain payment of, or to cause another bank to pay or to obtain payment of, a fixed or determinate amount of money that is to be paid to, or obtained from, a Receiver any and all settlement, accounting entries or disbursements that are necessary or appropriate to carry out the instruction.”

Why Did NACHA Create IAT?

- IAT came out of a growing need to provide a better means of tracking potential terrorist and money laundering activity within the ACH payment system
 - IAT provides a unique and expanded format
 - Identifies ACH files that are in any way associated with international payment activity
 - Provides additional information in the ACH files (especially regarding the originator and the receiver of the transaction)
 - Banks must screen IAT files against a Specially Designated Nationals (SDN) and Blocked Persons List provided by the Office of Foreign Assets Control (OFAC)
 - The SDN List identifies individuals and organizations with whom U.S. citizens and permanent residents are prohibited from doing business
-

Why should I care about IAT's??

My payroll only deposits money into employee accounts in the U.S.

It doesn't pay anyone internationally...



IAT is Surprisingly Broad in Scope

A Company Will Need to Use IAT -

1. If it sends to, or receives ACH transactions from outside the U.S. jurisdictional borders
2. If the ACH transactions are specifically funded by a bank office outside U.S. jurisdictional borders
3. If any receiver of a *domestic* ACH deposit (such as an employee) regularly then transfers that deposit amount to an account outside U.S. jurisdictional borders

ACH Participants that Are Most Likely to be Impacted

- Non-U.S. headquartered companies with U.S. operations
 - U.S. companies with pensioners or employees that may have funds forwarded to financial institutions outside of the U.S. jurisdictional borders
 - Third-Party Senders or Payment Aggregators
 - U.S. companies with vendors located outside of the U.S. jurisdictional borders
 - U.S. companies receiving ACH credit entries from offshore entities
-

IAT is All Very Nice in Theory... But We're Way Too busy!

...Why Should We Have to Comply with IAT?



Why Comply?...Here's Why!

- **OFAC can levy severe penalties for non-compliance**
- OFAC is a law enforcement arm of the U.S. Treasury



- Fines start at \$10,000 and can go as high as \$1,000,000 per violation. There is also the potential for imprisonment for extreme cases of willful and/or repetitive violations.
-

Why Comply?...Here's More!

- Originating Depository Financial Institutions (ODFIs) will also obligate an Originating Company or Third Party Sender to comply through the warranties in their ACH origination agreement or terms & conditions.
- Financial Institutions will be required to screen both inbound and outbound ACH IAT entries against the SDN list. There may be delays if an IAT entry does not contain the required information or if it needs to be scrutinized further.

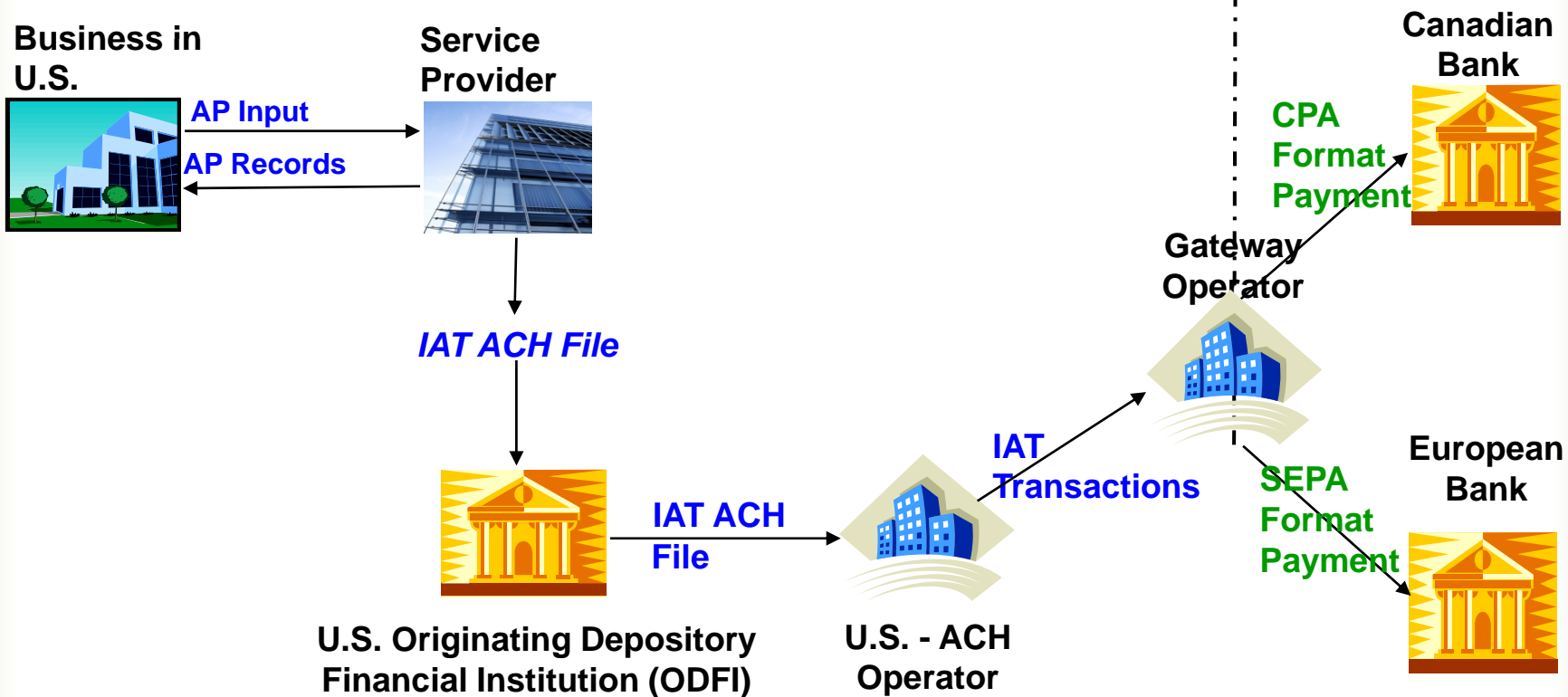
This IAT Process is Confusing! I Need to See Some Pictures!



Outbound IAT – True International Cross-Border Payments

United States

Outside U.S.

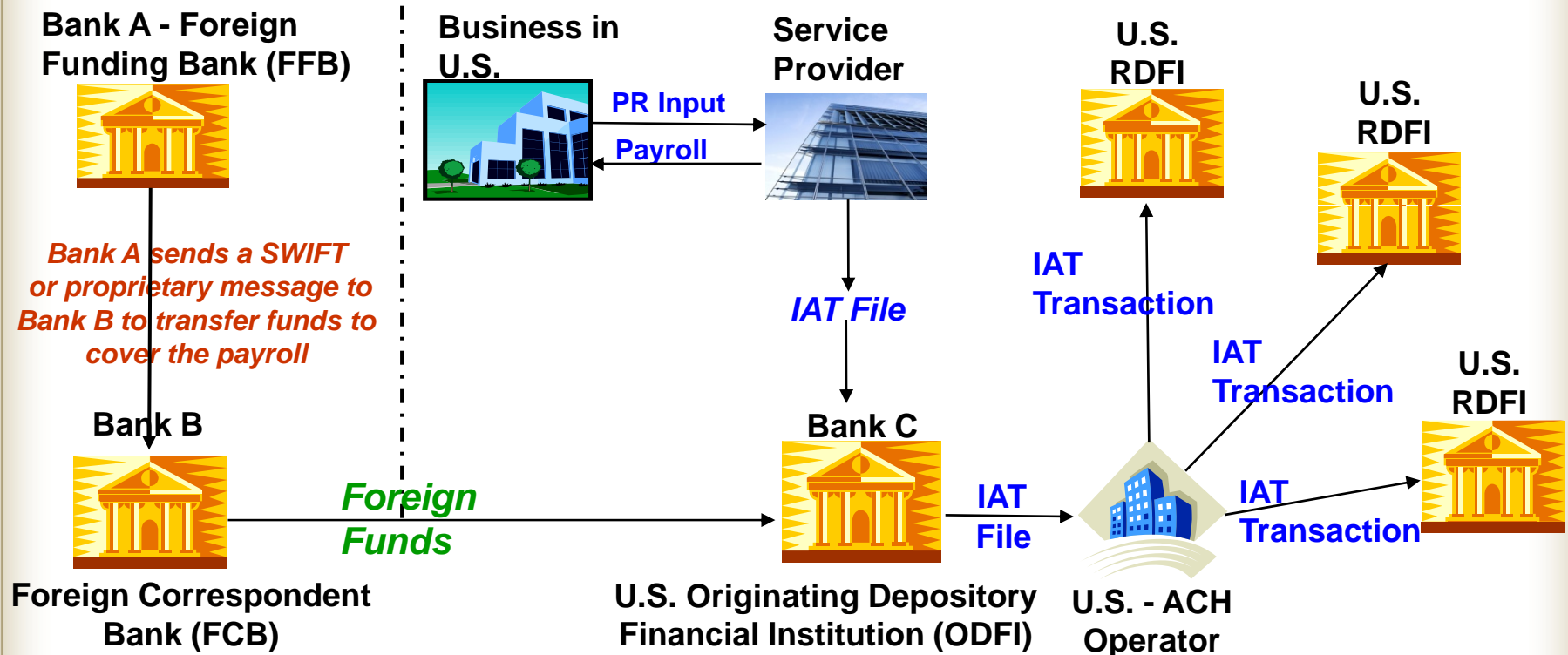


AP payments Created & Sent in IAT Format through the Gateway Operator to accounts outside U.S. jurisdictional borders

Inbound IAT - Foreign Funding

Europe

United States



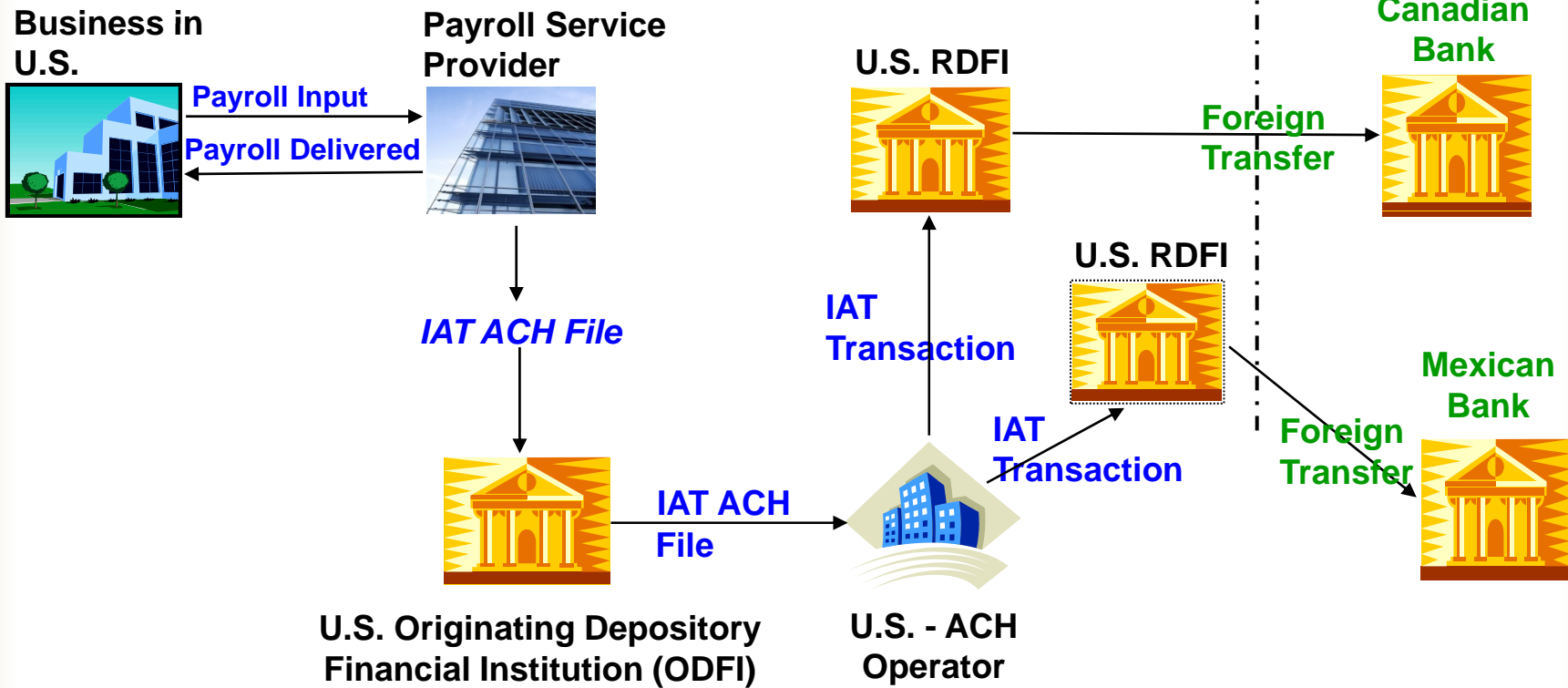
Bank B sends a SWIFT or proprietary message to the U.S. ODFI to further transfer funds to the U.S. ODFI – and for the U.S. ODFI to then transfer the funds to the client’s payroll account

Domestic Deposits Created, Sent & Posted in IAT Format

Outbound IAT – Employee Transfers

United States

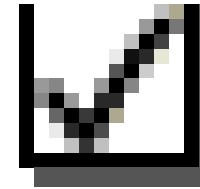
Outside U.S.



Direct Deposits Created, Sent & Posted in IAT Format into U.S. Domestic Accounts

Amounts Deposited into Domestic Accounts Then Transferred to Foreign Accounts

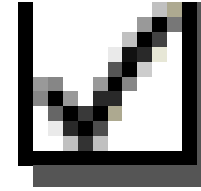
Conducting a Corporate IAT Compliance Assessment



- Identify all ACH applications within the corporation
 - Business Line Applications
 - Headquarters Internal Applications
- Send initial and then periodic communications to all employees & pensioners. Inform them of their responsibility to notify the company if they are doing any foreign transfers of the amount of their deposit funds
 - Sample letter on nacha.org, in the “News & Resource” area
- Apply an “IAT in Scope Checklist” periodically against each of the ACH applications to determine which, if any, require IAT

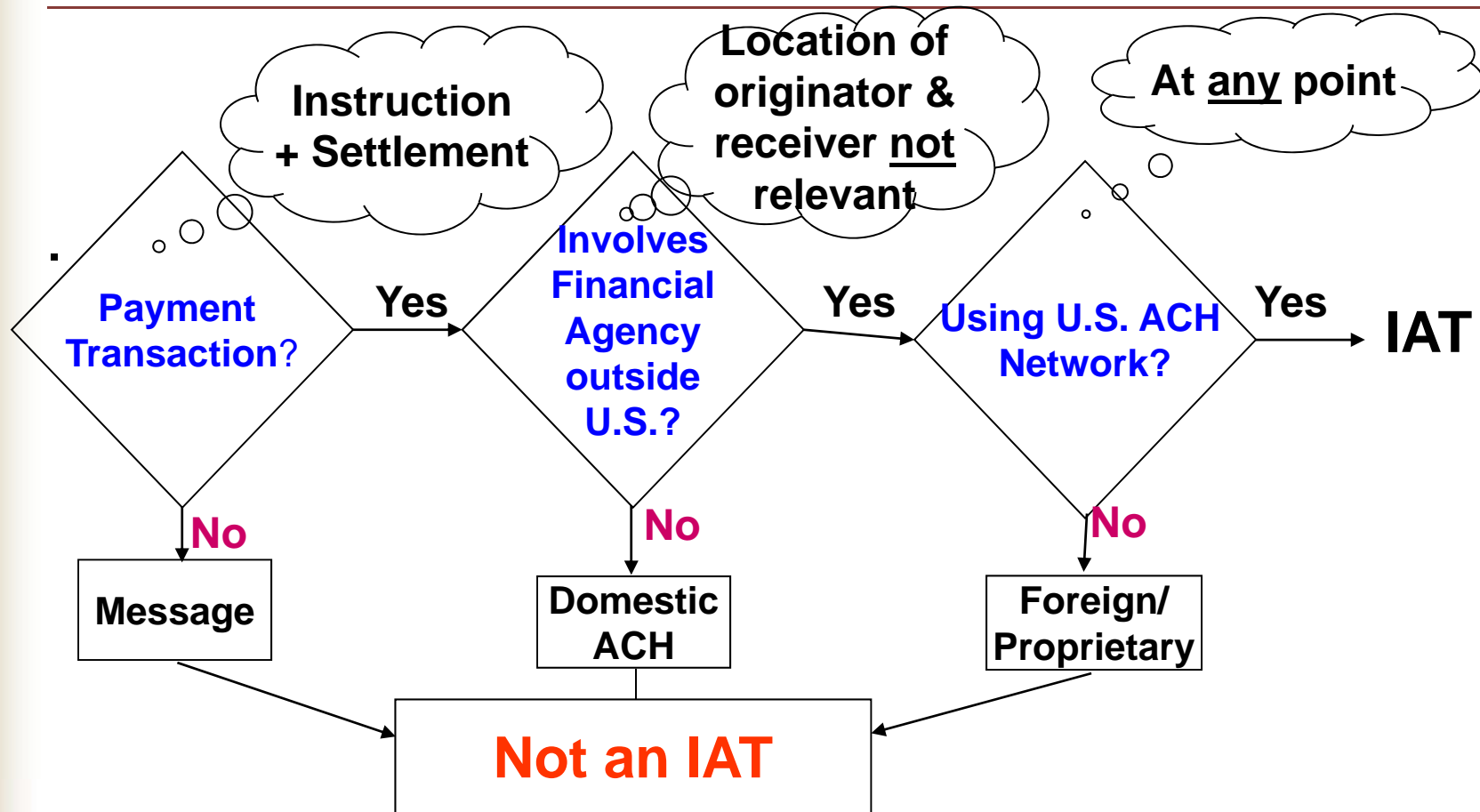
Conducting a Periodic Corporate IAT Compliance Assessment

“In Scope” Checklist



- Any ACH payments to foreign accounts?
 - If yes, those payments must be IAT
 - Any ACH payments from foreign accounts?
 - If yes, those payments must be IAT
 - Any ACH payments (even if domestic) specifically funded by a foreign account?
 - If yes, payments so funded must be IAT
 - Any declared employee or pensioner transfer of amount of domestic deposit to accounts outside the U.S.?
 - If yes, those feeder domestic deposits must be IAT
-

How to Determine IAT - Flow Chart



What to Do When IAT is Required

- Contact your U.S. bank and your service provider to determine the best approach and specific requirements
 - Written notification of IAT will likely be required
 - IAT Format must be used & fields must be specifically populated
 - Additional information will be required to populate the required fields of the IAT records generated, especially valid street addresses
 - Agreements & pricing may need to be modified
 - Determine whether any software changes are required
 - Other development priorities may need to be shifted
 - Funds may need to be allocated or other projects delayed
-

What to Do When IAT is Required

(Continued)

- Identify an alternate compliance plan until the software is in place and tested
- Testing, internally and then with the bank and/or service provider is essential to ensure the IAT file is compliant and that it will process without errors
- Bank and/or service provider approval of IAT format and field information will be required
- Work closely with your bank to ensure you have all the required IAT information, and read the Corporate Toolkit information on the NACHA website / IAT Resource area

Verify that All Interfacing Organizations (internal & External) are on the *Same* Development Track



- ❑ Communicate/share exact IAT specs up front
 - ❑ Verify that each organization you're interfacing with is using the same IAT specs (not a modified version), so all files will be compatible and seamless.
-

What to Do When IAT is Required

(Continued)

- Ensure that all receivers of IAT payments are not on the SDN “do not pay” list
- If IAT is not viable for some areas, consider moving that application to another payment method, such as checks
- If any debits to your accounts need to be IAT, see if the accounts have debit blocks/filters
 - If so, an additional IAT debit filter will be required, with the IAT TIN number identified.

What to Do When IAT is Required

(Continued)

- ❑ Keep in mind that IAT does not yet have an equivalent of the CTX format for financial EDI
 - IAT only allows up to 2 remittance records, as opposed to 9,999 for CTX
 - Your bank may need to work out an alternative with you
- ❑ Recognize that IAT transactions may at times take longer to process, and advise all impacted parties
 - IAT payments not required to be available until the evening of the effective date
 - IAT payments may at times be delayed by “hits” or “false hits” associated with the OFAC screening process at the banks

Understanding IAT and Following Key Guidelines Should Help to Make Your Company's Experience with IAT Easier

- **Going forward, when questions arise regarding your company's initial and ongoing IAT responsibilities**
 - Review the IAT section in the “News and Resources” area on nacha.org
 - Consider purchasing relevant NACHA publications
 - Consider NACHA-sponsored teleseminars on IAT
 - Consult with your bank
 - Consult with your internal legal & compliance staff

We Wish You - Smooth Sailing with IATs!



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FRB Response Study for IAT Readiness

Institution Type	Extremely and Very	Somewhat	Not Very and Not At All
Regional Commercial Bank	56%	34%	10%
Community or Savings Bank	10%	50%	39%
Credit Union	11%	49%	40%
Other	20%	47%	53%

FRB Survey for IAT Readiness

- How knowledgeable are you about your institution's roles and responsibilities (for example, internal operations and compliance, OFAC procedures) associated with sending and/or receiving IAT items?
- More of those surveyed this year (28% in 2009 versus 18% in 2008) consider themselves knowledgeable about their organization's roles and responsibilities (such as OFAC) associated with sending and receiving IAT items.

Institution Type	Extremely and Very	Somewhat	Not Very and Not At All
Regional Commercial Bank	61%	28%	11%
Community or Savings Bank	19%	56%	25%
Credit Union	21%	57%	21%
Other	29%	51%	20%

FRB Survey for IAT Readiness

- When do you expect that your organization will be ready to process IAT payments?
- Nearly all (93%) of those surveyed expect to be ready to process IAT payments by September 2009 or before.

Institution Type	Prior to the September, 2009 Effective Date	In Time for the September, 2009 Effective Date	We Have Concerns About Being Ready for the September, 2009 Effective Date
Regional Commercial Bank	27%	68%	5%
Community or Savings Bank	28%	67%	4%
Credit Union	33%	57%	10%
Other	50%	50%	0%

FRB Study for IAT Readiness

- For each of the following, please indicate which steps your organization has already taken and those it expects to take for the IAT.
- Nearly two-thirds (64%) of those surveyed have read the new NACHA rules and/or attended an educational or training session, been in contact with their ACH software vendor about the new code or begun discussions with their compliance officer about receiving IAT items.

Steps to Prepare for IAT	Already Taken	Expect to Take
Read the new NACHA rules and format	64%	34%
Attended an educational teleseminar or training session	57%	40%
Have been in contact with our ACH software vendor about the new code	56%	33%
Began discussions with our compliance officer about receiving IAT items	53%	39%
Contacted our RPA for assistance	35%	45%
Have been in contact with other software vendors about integrating the new code	34%	24%
Conducted an internal planning/training session	26%	65%
Began discussion with our originating customers about the new required data fields	14%	51%

FRB Survey for IAT Readiness

- Have you contacted your customers about their readiness to receive or send IAT-formatted items?
- Most (73%) of those surveyed have not yet contacted customers about readiness to receive or send IAT-formatted items.

Institution Type	Yes	No	Unsure
Regional Commercial Bank	15%	66%	19%
Community or Savings Bank	8%	79%	13%
Credit Union	23%	62%	15%
Other	0%	100%	0%

NACHA Review of IAT and Next Steps

What Does This Mean for an Originating Depository Financial Institution (ODFI)

- *Originating Depository Financial Institution (ODFI) Obligations (in addition to all other ODFI warranties and obligations defined within Article Two) include the following:*

1. Identification of Participants in an IAT entry

Definitions will be included within Article Fourteen to assist ACH participants in understanding IAT:

- Correspondent Bank: Participating ODFI that holds deposits owned by other financial institutions and provides payment and other services to those financial institutions.
- Foreign Gateway Operator: Gateway Operator that acts as an entry point to or exit point from a foreign country.

2. ODFI warranties for Outbound IAT entries with respect to compliance with U.S. law and compliance with foreign payment system rules.

This amendment consolidates consumer and non-consumer international payments under the same SEC code (IAT).

Unlike the U.S., international payment formats do not distinguish consumer and business transactions, thus hindering the ability to map foreign payment information in proper domestic format.

Outbound transactions to foreign entries must be mapped to one payment type.

What Does This Mean for an Receiving Depository Financial Institution (RDFI)

Exceptions for Outbound IAT entries.

- Article 2, Section 2.11.13 contains complete listing of exceptions.

- ***Receiving Depository Financial Institution (RDFI) Obligations include the following:***

1. *Return of Unauthorized IAT Entry*

- Specifically for Inbound IAT entries, the return of any unauthorized will be required to be transmitted by the RDFI in such time and manner that the return entry is available to the ODFI no later than the opening of the business on the banking day following the sixtieth calendar day following the settlement date of the original entry.

2. *Formatting Modifications*

- The current level of information contained within cross-border ACH transactions is not sufficient to allow the RDFI to identify all parties in the transaction.
- This amendment will require the IAT format to include the data required by the BSA's "Travel Rule" which is currently required of wire transfers. These elements will correspond to the SWIFT message format field lengths

IAT Volumes

- 2nd Quarter 2010 1,515,158
- Bank “A” Projected IAT volumes and \$ for 2010: 1MM items, 7 MM addenda, \$20B
- Network volume actually decreased 4.6% between Q1 and Q2, 2010
- Volumes are projected to grow 15% year over year through 2015, however
- Why is volume not increasing more markedly?

IAT considerations

- Impact of recent FED announcement concerning FI's
- The FED proposed that FI's report ANY payment that is sent cross-border, regardless of dollar amount
- Current limit is \$10,000 or over
- Would IAT be impacted by this proposal?
- What impact would there be for the FI?

Other Implications

- **Has IAT been viewed as a success within the industry?**
 - Several clients have expressed their displeasure with the rule change
 - Many clients have not yet deployed IAT; They either perform OFAC themselves
Survey done a few years ago indicates there is not a strong appetite for higher pricing.
- **Education is still an issue**
 - NACHA/EPN Webinars
 - F.I. discussion and meetings with their clients
 - Greatest challenge has been in identifying exactly what an IAT is
 - Most clients view IAT not as a domestic, but international, ACH transaction
- **Handling of OFAC “positive hits” thusfar**
 - Minimal issues have been reported
 - Occasional deployment problems with invalid addenda
Potential increased NSF's and closed accounts?
Service implications?
- **Use of R 17 as the identifier of an IAT return**

What lies on the Horizon with IAT?

- Potential NACHA rule deployment and changes
- Potential impact to the originator
 - Deployment of further rule changes for IAT falls to all participants to re-educate and potentially re-deploy
 - Re-testing may be needed

IAT Enhancements – RFC Issues

- Clarification on Effect of Illegality
 - Clarification of minimum description standards for IAT entries
 - Requirements for Gateway agreements for Outbound IATs
 - Clarifications to Originator ID Field and fields identifying Originating DFI on Inbound IATs
 - New Transaction Type Code for worker remittances
 - Return reason code for Entry Returned per OFAC Request
 - New Return Reason Code and Notification of Change Code for domestically-coded entries
 - Clarification of corrected data field lengths for IAT usage in descriptions of NOCs
 - Clarification that R80-R84 are for Outbound IATs only
 - Notification by Gateway for rejected inbound IAT
 - Clarification of language on rules exceptions for Outbound IAT Entries
-

IAT Enhancements – RFI Issues

- Desire for additional remittance addenda for IAT entries
- Potential operational issues related to secondary SECs within IAT
- Potential requirement to use ISO Country Codes in Addenda Records
- Identification of additional parties within IAT entries

IAT Enhancements – RFI Issues

- Issues NOT being proposed by PG
 - Mandatory use of OFAC Screening Indicators
 - Messaging through ACH Network to communicate “hard hit” via zero-dollar IAT
- Additional comments on “post-implementation assessment”

IAT Enhancements - Timeline

- RFC is expected to be issued in 4Q
- Some portions are proposed to become effective March 18, 2011; others are proposed for September 16, 2011

Agenda

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What's Beautiful about IAT?

- It was a long and painful journey
 - Since this was not an OFAC directive there was very little guidance from OFAC on how to implement
 - NACHA and the industry took the lead in self-regulating, but the interpretation of “what needed to be done” was conflicting and produced lots of questions
 - \$400 to \$500 million has been quoted as the cost for IAT implementation, but as of May there were no true hits reported
 - Enhancements equal additional costs - what is the ROI?
-

The Internet has Globalized Communication and Business

WORLD INTERNET USAGE AND POPULATION STATISTICS

World Regions	Population (2010 Est.)	Internet Users Dec. 31, 2000	Internet Users Latest Data
<u>Africa</u>	1,013,779,050	4,514,400	110,931,700
<u>Asia</u>	3,834,792,852	114,304,000	825,094,396
<u>Europe</u>	813,319,511	105,096,093	475,069,448
<u>Middle East</u>	212,336,924	3,284,800	63,240,946
<u>North America</u>	344,124,450	108,096,800	266,224,500
<u>Latin America/Caribbean</u>	592,556,972	18,068,919	204,689,836
<u>Oceania / Australia</u>	34,700,201	7,620,480	21,263,990
WORLD TOTAL	6,845,609,960	360,985,492	1,966,514,816

NOTES: (1) Internet Usage and World Population Statistics are for June 30, 2010. (2) Demographic (Population) numbers are based on data from the [US Census Bureau](#) . (3) Internet usage information comes from data published by [Nielsen Online](#), by the [International Telecommunications Union](#), by [GfK](#), local Regulators and other reliable sources. Data compiled by www.internetworldstats.com

There are opportunities

- Opens the US ACH to global/international use
- Provides payments rails for companies and merchants of all sizes to expand business outside US without having to establish banking relationships in other countries
- Provides opportunities to financial institutions to build/expand on international origination services to its customers

IPF - International Payments Framework

- The IPFA has been working with banks, infrastructure providers (like FedACH and EPN) and organizations like SWIFT and NACHA to define a framework for cross-border non-urgent payments
- With the IAT format in place, defining mapping between the US and other countries was made simpler than having multiple customized formats to map between

IAT – in summary...

- Good – Industry self-regulated
- Bad – Lack of clarity and communication
- Ugly – Resources (\$\$ cost and people time)
- Beautiful – Opportunity for future growth in international payments for organizations of all sizes